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SUBJECT: ARMENIA ENJOYS FOUR YEARS OF DOUBLE-DIGIT
GROWTH

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SUMMARY

¶1. (SBU) For the fourth year in a row, Armenia's gross domestic product (GDP) grew at a double-digit rate according to National Statistical Service data. (Note: The International Monetary Fund (IMF) has consistently praised the National Statistical Service for the quality of its data. End Note.) In 2005, Armenia's GDP grew by 13.9 percent, driven primarily by construction. Year-on-year inflation during 2005 was 0.6 percent. Budget revenues and expenditures increased by 25.2 and 33.5 percent respectively in terms of local currency. (Note: The percentage change appears skewed when calculated in dollar equivalents because there has been a 14.2 percent appreciation of the dram over the past year. End Note.) Tax revenue as a percentage of GDP remained low at 14.4 percent. Both exports and imports grew steadily at rates of 31.5 and 30.9 percent respectively. Foreign investments in Armenia grew by 28.7 percent. The official unemployment rate fell to 7.6 percent (revised from 7.7, ref A) and the average salary increased by 19.5 percent. End Summary.

MACROECONOMIC OVERVIEW: GDP GROWS BY 13.9 PERCENT

¶2. (SBU) Armenia's GDP grew at an impressive rate of 13.9 percent in 2005 and was valued at USD 4,867 million (AMD 2,228 billion) according to the National Statistical Service. (Note: The IMF cited the Armenian National Statistical Service as providing a good example for other countries in the region and commended Armenia for its "significant efforts to bring its official statistics in line with international standards." End Note.) Last year was the fourth consecutive year that Armenia enjoyed double-digit growth. GDP per capita in dollar terms grew by 37 percent and reached USD 1,514. Approximately 15 percent of that growth, however, resulted from the continuing appreciation of the national currency, the Armenian dram. As in previous years, construction was the primary driver of GDP growth, up by 34.2 percent and contributing 5.4 percentage points to the overall GDP growth rate. Agricultural output grew by 11.2 percent (contributing 2.5 percentage points to GDP

growth) and industrial production grew by 7.5 percent (making up 1.4 percent of GDP). Consumer purchasing power also increased thanks in large part to remittances, which officially reached a net inflow of USD 352 million, up by 27 percent compared to 2004.

13. (SBU) Construction spending totaled USD 931.6 million and was largely privately financed (88.8 percent). Approximately 47 percent of total construction was construction/repair of residential buildings and houses. Fourteen percent of the growth in the construction sector came from development of transportation and communication systems and 39 percent was construction in the non-residential sector. Thanks to recently announced assistance projects sponsored by the Lincy Foundation (USD 60 million) and the Millennium Challenge Account (USD 235.65 million), the construction sector is likely to remain strong in the coming months.

14. (SBU) In 2005, favorable weather conditions supported a significant increase in agricultural output (11.2 percent). Industrial sector growth was based primarily in metallurgy (34.9 percent), which enjoyed a 19.4 percent share in the volume of total industrial production. Production of tobacco products was up 14 percent, chemical production was up 57.1 percent, rubber and plastic was up 37.1 percent, publishing was up 15.6 percent, and food processing, including beverages, was up 4.1 percent.

PRICES DECREASE

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15. (SBU) The abundant agricultural harvest drove down food prices resulting in annual deflation of 0.2 percent (December 2005 compared to December 2004). Year-on-year inflation was 0.6 percent. Prices for construction materials rose by 18.5 percent and the producer price index for industrial products rose by 7.5 percent due to price increases for non-ferrous metals (up by about 44 percent). A 9.3 percent decrease in the price index for agricultural products together with increased prices for construction materials and industrial products resulted in a GDP deflator of 3.1 percent.

BUDGET REVENUES AND EXPENSES INCREASE

16. (SBU) According to preliminary data from the Armenian Ministry of Finance and Economy (published by the National Statistics Service), budget revenues for 2005 were USD 814.83 million (up by 25.2 percent if calculated in terms of local currency over the previous year). Expenses totaled USD 863.4 million (an increase of 33.5 percent). Collected tax revenues were USD 702.5 million (up by 20.4 percent). This number includes "state duties" which are listed as a separate line in the National Statistics Service reporting. The increase was due largely to increased VAT collections which reached USD 320.70 million (up 24.5 percent) and increased corporate tax collections which reached USD 320.7 million (up 45.4 percent). Indirect taxes, such as VAT and excise taxes, fell slightly as a share of total tax revenues from 59.4 percent in 2004 to 57.7 percent in 2005. Expenditures on education, and science and health increased to USD 128.5 million (up 30.2 percent) and USD 66.5 million (up 25.3 percent), respectively. Despite the increase, the share of education and health expenditures to GDP remained low at 2.6 percent and 1.4 percent, respectively. The high

growth in GDP notwithstanding, the tax ratio to GDP increased only slightly, up 0.3 percent to 14.4 percent.

FOREIGN TRADE EXPANDS

¶7. (SBU) During 2005 both exports and imports grew substantially, by 31.5 percent and 30.9 percent respectively, with exports reaching USD 950.4 million and imports USD 1,767.9 million. The trade deficit increased by 28.5 percent to USD 817.5 million. (Note: The trade deficit is calculated in USD and the GDP is calculated in AMD. Due to the 14 percent appreciation of the dram, the trade deficit as percent of GDP actually fell from 17.9 percent in 2004 to 16.8 percent in 2005. End Note.) Armenia's primary trading partners remained Russia (14 percent of total trade), Germany (10.6 percent), Belgium (9.9 percent), Israel (7.9 percent), USA (6.4 percent), Ukraine (5.1 percent) and Iran (4.0 percent). Diamond trade turnover was USD 533.9 million and grew by 20.2 percent compared to ¶2004. Precious and semi-precious stones and metals accounted for the largest share of exports at 35.4 percent, an increase of 12.4 percent. Non-precious metals followed, accounting for 33 percent of exports, an increase of 230 percent over 2004 and food products accounted for 10.2 percent of exports and were up by 39.7 percent.

FOREIGN INVESTMENTS GROW

¶8. (SBU) Foreign investment increased by 28.7 percent during the first nine months of 2005, and reached USD 225.7 million. The largest investments were still in telecommunications, with 40.1 percent of total investments, followed by investments in metallurgical industry (13.3 percent) and mining (12.9 percent). Russian investments were USD 36 million, for 16 percent of total investments. U.S. investments reached USD 16.7 million (7.4 percent of total investments) with USD 9.3 million directed at the IT sector. Cyprus (largely via Russian-controlled funds) invested USD 9.4 million with the major part of investments directed at the hotel business and the construction of the Golden

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Palace Hotel in Yerevan. An Argentinean company invested USD 6.4 million in airport development.

REDUCTION IN FOREIGN DEBT BURDEN

¶9. (SBU) Armenia's foreign debt at the end of 2005 was USD 1,161.1 million constituting 23.9 percent of GDP (compared to 33.3 percent in 2004). The GOAM forecasts that foreign debt will increase in 2006 to USD 1.2 billion, however given GDP growth, the debt-to-GDP ratio is expected to decrease to 21 percent. (Note: The Central Bank of Armenia has forecast 10 percent GDP growth in 2006. End Note.)

EMPLOYMENT AND WAGES INCREASE

¶10. (SBU) According to National Statistical Service data, the official unemployment rate fell from 9.3 percent to 7.6 percent as of the end of December 2005. International organizations estimate, however, that the real unemployment rate is between 15 to 25 percent (ref A). According to official data, 70.1 percent of

unemployed were between 31 to 50 years old, and 72.4 percent were women. Average nominal monthly wages for January-December 2005 increased by 19.5 percent to AMD 52,040 (approximately USD 114). There were wage increases in both the public and private sectors - 23.9 percent and 17.1 percent, respectively. The highest wages were in the financial sector (about USD 370) and construction (USD 150). The Statistical Service did not include salaries from international organizations and diplomatic missions which were often much higher than the salaries quoted above.

COMMENT: GOAM PLAGUED BY LARGE SHADOW ECONOMY

¶11. (SBU) The Armenian economy continues to enjoy strong growth with steady macroeconomic environment and positive indicators in many areas. Although there has been progress in tax collections, the tax-to-GDP ratio is still low, suggesting that a large portion of the Armenian market remains in the shadow economy. While the GOAM has been able to increase public expenditures, particularly in the critical areas of education and health spending, corruption and black-market activity continue to undermine the government's ability to maximize the benefits of the country's impressive growth rates.

EVANS